BEFORE THE
COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

D.T.E. 04-115 July 22, 2005

REPLY COMMENTS OF MIRANT CORPORATION AND CALPINE CORPORATION

Procurement of Default (Basic) Service Power Supply for Residential and Small Commercial and Industrial Customers

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I. INTRODUCTION

Mirant Corporation and Calpine Corporation ("the Companies") appreciate the opportunity to participate in the DTE's ongoing proceedings regarding procurement for small commercial/industrial and residential customers. The Companies are owners of significant generation portfolios in Massachusetts (combined 1,549 MWs) and in the New England region (combined 2,658 MWs) and have previously been suppliers of Standard Offer/Basic Service. Additionally, Mirant and Calpine are licensed as retail suppliers in the Commonwealth. Mirant was the initial supplier to the Cape Light Compact municipal aggregation program. In addition the Companies currently serve commercial and industrial customers throughout the state at retail.

First, we would like to commend the DTE for its continued dedication to the development of robust, competitive energy markets. As stakeholders at the June 20th Technical Conference noted, many competitive options for larger customers already exist today and, with time and patience, we believe that such options will undoubtedly materialize for smaller customers.

Before addressing the specific questions the Commission used to frame discussions at the Technical Conference, the Companies would like to make a few overarching observations and suggestions:

1. All stakeholders agreed that a solution must be achieved for smaller customers that balances the need for price stability and market price reflectivity. Clearly there is not a "silver bullet" or "right" answer, but rather the Commission should determine its end-state vision for these smaller customers. Knowing this vision will allow stakeholders to work with the Commission to design an appropriate retail market structure.
   - Constellation New Energy posed the question well, "Do you want the lowest stable price, or do you want a price that perhaps allows competitors to come in and offer other types of services?" (Transcript p 66).
   - A second set of questions that could be addressed is what role the Commission ultimately envisions for the distribution companies? For example, should they remain as the "middle men" in the supply procurement function? Should they maintain a "provider of last resort" obligation? A billing and collections obligation?
   - The Companies encourage the Commission to review the survey submitted by the Attorney General in helping to determine its end-state vision, as the vision should aim to satisfy the needs expressed by end-use customers.

2. All stakeholders agreed that suppliers cannot "time the market." In fact, unless all customers are on a real time price, there will be a disconnect with the market price. No matter the contract term, if market prices are trending upward and the contract has been locked in at a

lower rate it appears beneficial to consumers. The reverse is true if market prices are trending downward. Regardless of the exact mechanism eventually chosen, customers are more likely to reap benefits of lower market prices through a competitive process than in a regulated, non-competitive market.

3. With a few exceptions, stakeholders seem generally pleased with the current Basic Service procurement methodology used in the Commonwealth. The Companies did not hear any suggestions for drastic change, only for relatively minor adjustments.

4. Many stakeholders, including WPS, Dominion Retail, Direct Energy and DOER Commissioner O'Connor, expressed satisfaction with aggregation programs. Understanding that this is primarily under the purview of the DOER, perhaps the DTE, DOER and stakeholders could again examine ways to reinvigorate aggregation activities at the municipal or other aggregated levels.

5. The Companies are aware of at least one potential pilot program (discussed by National Grid) that may be filed with the Commission. We are not opposed to such programs, however we would discourage a proliferation of differing pilot programs (as is currently occurring in New York) due to the administrative complexity and potential customer confusion when a number of pilot programs are tested simultaneously.

6. Finally, the Companies would like to reiterate comments made in our initial individual filings in this docket regarding financial assurance requirements for the existing Basic Service

procurement. As mentioned, the Companies own a substantial amount of generation in the Commonwealth. However, due to restrictive financial assurance requirements we are essentially precluded from directly contracting with the investor owned utilities in the state. As such, we can price our product at X to other suppliers, who then add a margin and re-sell our product at X+ in the Basic Service RFP. As stated in Mirant's earlier filing, many of the entities that win RFPs for default service today satisfy the applicable credit related requirements but have no assets and must contract with generators like Mirant and Calpine to serve the default load. That is, these winners are often middlemen between end-users and generators. Since many generators are effectively restricted to acting as suppliers for the winning bidders, the number of potential bidders is significantly reduced. Ultimately, this decrease in competitive bidders hurts customers.

We encourage the Commission to review current credit assurance practices to determine if there are any solutions that might address this issue.

II. RESPONSES TO QUESTIONS POSED BY THE COMMISSION

Laddered Resource Portfolio Approach

Is a laddered approach (i.e., a portfolio of several shorter and longer-term contracts procured for overlapping terms) likely to produce lower prices for smaller customers?

- A laddered portfolio approach will not necessarily lead to lower prices for smaller customers. As National Grid pointed out in its comments to the Commission, the laddered approach includes a range of longer-term contracts, essentially reducing the connection between Basic

Service prices and the underlying wholesale market (Transcript p 28). Further, by including longer-term contracts, suppliers must factor migration risk into their Basic Service bid.

- A laddered resource portfolio approach may provide some price stability, but the analysis conducted by both NSTAR and National Grid using historical data suggests that such an approach would not track much differently than today's methodology.

Would the implementation of a laddered approach act as a barrier to the development of competitive options for smaller customers?

- Yes, it would be a barrier to the development of competitive options and works against full retail competition. If you look at New Jersey, for example, which uses the laddered approach, the switching rate at the residential level is less than 1%. Depending on the Commission's ultimate vision for customers, this may or may not achieve its goals for competition.

- In a rising market it is virtually impossible for competitive suppliers to compete with prices that blend lower rates from one, two or three years ago. If prices are falling and the Basic Service blended rate is actually higher than the current market, competitive suppliers would have the ability to compete. This entire scenario, however, leads to a boom/bust cycle for consumers and suppliers alike.

Renewable Resources

Should long-term contracts for renewable resources be included as a component of the procurement of power supply for default/basic service?

- The Companies realize the importance of renewable resources on a going forward basis and to achieving renewable portfolio standards set by the Commonwealth. However, we do not believe it is necessary or appropriate to give such resources preferential treatment via long-term contracts. Traditional generation resources face the same siting, permitting and financing hurdles as renewable resources yet do not have the luxury of Commission approved long term contracts with utilities. Further, while renewable resources are necessary in meeting the RPS standards, traditional generation is necessary in meeting reliability standards. Both are critical to a vibrant energy market in New England but we believe that appropriate market mechanisms will deliver the investment dollars needed to build these additional megawatts.

- The DOER's forecast for renewable facilities' development in the region shows that even with a minimum development scenario we can meet RPS targets by 2008. The DOER's "likely" scenario projects that even without Cape Wind we can meet minimum RPS requirements by 2008 (Transcript p 108-109). As such, it seems unnecessary to require long term contracts for renewables.

- Further, market forces are working as evidenced by the long-term contracts that Constellation New Energy has signed with renewable energy and REC suppliers (Transcript p 124). Others, such as Commissioner O'Connor, noted that the Mass. Technology Collaborative's Green Power Partnership program has already provided $50 million for contracts with a number of renewable developers with a second round of financing at the $40 million level soon to be available for the development of projects through additional long term contracting (Transcript p 144-145).

- Another point to consider is that wholesalers such as Mirant and Calpine take on the RPS obligation when serving retail suppliers. As noted by WMECo there would be great disparity with a one-year contract obligation for Basic Service that has a requirement for an associated long term renewable component (Transcript p 144).

Expanding Customer Choice for Smaller Customers

What steps could the Department take to increase the competitive options for residential and small commercial and industrial customers?

- As mentioned previously, the Companies feel that further development of municipal aggregation programs could bring greater benefits to residential and small commercial and industrial customers in the Commonwealth. Several other stakeholders, including WPS, Dominion Retail, Direct Energy and Commissioner O'Connor, expressed interest in aggregation programs. These programs greatly reduce customer acquisition costs and the large blocks of load are attractive to both retail and wholesale suppliers.

- Dominion Retail also initiated an important discussion regarding the transfer of customer accounts from the investor owned utilities to the competitive suppliers. Our experience is similar in that the Companies have encountered difficulty with customer account number and other data exchanges. We encourage the Commission to consider ways to facilitate these data transfers while maintaining customer privacy and protections.

- Another option the Commission may wish to consider is gradually increasing the number of customers on quarterly or even real time procurement basis. In New Jersey and Maryland, for example, only the largest customers were initially on fluctuating spot prices. Naturally, many of these customers sought competitive supply options in order to hedge their energy costs. Over time both states have extended spot pricing to customer classes with lower load factors. To date no regulatory bodies have extended this mechanism all the way down to the residential level, but it could be a means of increasing competitive options for small commercial and industrial customers in the Commonwealth.

- Over the long term, in order for competitive suppliers to offer sustainable products in Massachusetts, it will be important for consumers to migrate entirely from utility provided Basic Service. In order to achieve this, utilities could be required, for example, to educate consumers on the competitive options available to them and/or place the name of the winning Basic Service supplier on the customer bill.

Are there successful initiatives in other states that could be introduced into the Massachusetts retail market?

- One example of successful non-municipal aggregation can be found in a program designed by the Baltimore/Washington Corridor Chamber of Commerce (BWCC). The program was initiated to educate business owners about electric deregulation and its impact on energy costs has resulted in a program that brought a $680,000 annual savings to these proactive participants.

Working with an energy management consulting firm, the BWCC put together over 330 accounts for 127 member companies, non-profits and institutions in mid-Maryland. The total electric usage by the group is over 10 megawatts (MW). The Chamber was able to provide contracts for all account types, including the small Type 1 customer accounts, who will realize at least an 8% reduction in rates in the first twelve months of the new service.

Five companies licensed to sell electricity in Maryland bid on the cooperative's load, with the winning bidder securing a long term contract to May 2008. Based on the current Standard Offer Service rate, the group collectively should save more than $680,000 in the first year of this 36-month contract. The cumulative savings estimate for the full term of the contract could be $2.2 million.

- A further example of a successful municipal aggregation program is the Northeast Ohio Public Energy Council (NOPEC). According to its website, NOPEC, is made up of 112 member communities, large and small, spread across eight Northeast Ohio counties. Voters in each of these communities approved the formation of NOPEC in November, 2000, by passing ordinances that authorized their local government to aggregate all utility customers within the community.

  The concept of NOPEC is a simple one. By banding together into one large buying group, the communities gain leverage in the deregulated marketplace. The individual utility customers NOPEC represents enjoy the advantages of bulk buying power, professional expertise, and consumer advocacy on their behalf. With more than 600,000 potential customers, NOPEC is the largest public aggregation in the United States

A wealth of information, including program structure, can be found at www.nopecinfo.org.

- Another idea for the Commission to consider is that utilities in many states offer solutions designed to minimize the bad debt risk faced by competitive suppliers. These "purchase of accounts receivable" programs are commonly offered by utilities whereby the utility receives a discount on the supply price in exchange for insulating the competitive supplier from uncollectible revenue. The utility is already well positioned to bill customers and follow up with those who do not pay. Many competitive suppliers view this as a very valuable service. This topic was discussed at length during the Technical Conference and the Companies urge the Commission to evaluate this option.

The Companies appreciate the opportunity to submit reply comments in this proceeding and look forward to an ongoing dialogue with the Commission on these and other issues.

Respectfully submitted,

Sarah M. Stashak
Mirant Corporation
Manager, External Affairs – New England

Thomas W. Kaslow
Calpine Corporation
Director, Market Policy and Regulatory Affairs